



## MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE SIX MONTH PERIOD ENDED MAY 31, 2009

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July 23, 2009

Torque Energy Inc. ("Torque" or the "Company") is a Canadian-based oil and natural gas company whose common shares are traded on the TSX Venture Exchange (TSX-V) under the symbol "TQE".

The Company's business is the acquisition, exploration, development and any other opportunities related to the operation and production of oil and natural gas properties. It conducted its activities in the provinces of Ontario and Alberta.

The following Management's Discussion and Analysis (MD&A) should be read in conjunction with the unaudited interim financial statements for the six months ended May 31, 2009 together with the notes thereto and the audited consolidated financial statements and MD&A for the year ended November 30, 2008, and is based on information to July 23, 2009. The reader should be aware that historical results are not necessarily indicative of future performance. Additional information relating to Torque can be found at [www.sedar.com](http://www.sedar.com) and [www.torqueenergy.com](http://www.torqueenergy.com)

This MD&A may contain forward-looking statements including expectations of future capital programs and commodity prices. These statements are based on current expectations that involve a number of risks and uncertainties, which could cause actual results to differ from those anticipated. These risks include, but are not limited to: operational risk in development, exploration and production; delays or changes in plans with respect to exploration or development projects or capital expenditures; and commodity price and exchange rate fluctuation and uncertainties.

The financial data contained herein is presented in Canadian dollars and has been prepared in accordance with Canadian Accepted Accounting Principles ("GAAP"). In conformity with Canadian Securities Administrators National Instrument 51-101, natural gas volumes have been converted to equivalent barrels of oil ("BOE") using a conversion ratio of six Mcf (one thousand cubic feet = Mcf) to one BOE. Readers are cautioned that BOEs may be misleading, particularly if used in isolation.

### NON-GAAP MEASURES

The Company uses certain measures of financial reporting in the MD&A that are commonly used as benchmarks within the oil and natural gas production industry. They are widely accepted measures of performance and value within the industry, and are used by investors and analysts to compare and evaluate oil and natural gas exploration and producing entities.

These measures and their underlying calculations are not defined by Generally Accepted Accounting Principles ("GAAP") in Canada and consequently are referred to as non-GAAP measures. These measures may not be comparable to a similarly titled measure of another entity. When these measures are used, they should be given careful consideration by the reader.

Included in the MD&A are references to the following non-GAAP terms:

***Funds flow from operations*** is determined before changes in non-cash working capital items, and is used as a key measure of performance and liquidity.

***Field level cash flow*** refers to oil and gas sales revenue less royalties and less operating expenses. It does not include other income or any of the other company expenses that are used to calculate net income.

*Operating netback* is a benchmark used in the crude oil and natural gas industry to measure the BOE contribution of oil and natural gas sales subsequent to the deduction of royalties, operating and transportation costs.

## RESULTS OF OPERATIONS

For the three months ended May 31, 2009, the Company realized net income of \$30,816 (\$0.00 per share) versus net income of \$549,103 (\$0.04 per share) for the same period in 2008. For the six months ended May 31, 2009, the Company recorded a net loss of \$20,317 (\$0.00 per share) versus net income of \$843,387 (\$0.06 per share) for the same period in 2008.

The overall reduction in net income can be attributed entirely to lower net revenues resulting from the economic factors affecting the global price for crude oil and North American prices for natural gas. During the six months ended May 31, 2009, the Company averaged \$49.50 per barrel of oil sold versus an average of \$96.70 per barrel of oil sold during the same period in 2008. This represents a 49% reduction in the average price per barrel of oil sold. During the three months ended May 31, 2009, oil prices have rebounded and the Company received a 25% increase in the average price per barrel for its crude oil production.

Natural gas sales during the six months ended May 31, 2009 averaged \$6.35 per Mcf versus \$9.80 per Mcf for the same period in 2008. This represents a 35% reduction in the average price per Mcf sold. During the three months ended May 31, 2009, the Company suffered a 15% reduction in the average price per Mcf for its natural gas production.

At the same time as prices were declining, the Company was successful in sustaining production levels for both oil and natural gas. For the six months ended May 31, 2009, oil production compared to the same period in 2008 was very similar showing only a 2% reduction (see Production History and Sales Summary). Natural gas production during the six months ended May 31, 2009 increased approximately 58% compared to the same period in 2008. The increase represents the contribution from the Company working interest participation in the Mikwan wells (Alberta) which commenced initial production during the third quarter of 2008.

Overall expenses remained at very manageable levels. For the six months ended May 31, 2009, overall expenses increased approximately 7% compared to the same period in 2008. The majority of the overall increase was observed in operating costs related to various accrued estimates for the Mikwan production and a reduction in Q2 2008 repairs and maintenance in the Dover East field while more modest increases were observed in general and administration costs related to labour and labour-related expenses. These increases were offset by reduced interest costs that occurred as a result of declining interest rates and overall lower bank indebtedness.

During the six months ended May 31, 2009 there were no new significant commitments made that would or may have a material impact on the Company's future performance or financial position. The Company continues to be exposed to the normal risks associated with global oil prices and North American natural gas prices and will be affected accordingly.

The Company averaged 154 BOE (barrels of oil equivalent) sold per day for the second quarter of 2009 compared to 142 BOE per day for the same period in 2008. New production from the Mikwan property contributed approximately 14 BOE/day.

Total bank indebtedness at May 31, 2009 decreased to \$2,438,496 from \$2,485,409 at November 30, 2008.

## SELECTED QUARTERLY INFORMATION

\$, except as indicated	Three months ended May 31			Six Months ended May 31		
	2009	2008	2007	2009	2008	2007
Revenue (net of royalties)	619,250	1,108,264	849,688	1,167,060	1,953,292	1,498,935
Funds flow from operations Per share - basic & diluted	187,030 0.01	733,442 0.05	370,974 0.03	223,158 0.02	1,196,331 0.08	540,297 0.04
Net earnings (loss) Per share - basic & diluted	30,816 0.00	549,103 0.04	117,220 0.01	(20,317) 0.00	843,387 0.06	66,633 0.00
Total assets	11,171,354	11,224,212	11,170,524	11,171,354	11,224,212	11,170,524
Bank indebtedness	2,438,496	3,238,175	4,308,386	2,438,496	3,238,175	4,308,386

## SELECTED INFORMATION FOR LAST EIGHT QUARTERS

\$000s, except as indicated	2009		2008				2007	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Revenue (net of royalties)	619.3	547.8	978.7	1,235.0	1,108.3	845.0	804.4	840.9
Funds flow from operations Per share - basic & diluted (\$)	187.0 0.01	36.1 0.00	226.5 0.02	820.5 0.06	733.4 0.05	462.9 0.03	353.1 0.02	375.4 0.03
Net earnings (loss) Per share - basic & diluted (\$)	30.8 0.00	(51.1) 0.00	180.9 0.01	659.1 0.05	549.1 0.04	294.3 0.02	127.5 0.01	175.6 0.01
Total assets	11,171.4	11,174.3	11,159.8	11,449.4	11,224.2	10,963.8	11,077.4	11,217.1
Bank indebtedness	2,438	2,504	2,485	2,885	3,238	3,663	4,043	4,332

Even with the dramatic fluctuation of global prices of crude oil and North American natural gas the Company, over the last eight quarters, continued to generate positive funds flow from operations which were used to reduce bank indebtedness while increasing total assets (net of depletion). Depletion for the last eight quarters totalled \$1,460,808. The Company maintained net earnings over the last eight quarters other than in Q1 2009 when oil and natural gas prices slipped to \$42.20/BOE from a high in Q3 2008 of \$110.50/BOE.

## FUNDS FLOW FROM OPERATIONS

Funds flow from operations decreased 74% in the second quarter of 2009 to \$187,030 or \$0.01 per share on a diluted basis from \$733,442 or \$0.05 per share on a diluted basis for the second quarter of 2008. This is primarily a result of decreased commodity prices. Funds flow from operations is calculated as follows:

\$, except as indicated	Three months ended May 31			Six months ended May 31		
	2009	2008	2007	2009	2008	2007
Cash provided by operating activities	127,151	576,912	241,742	358,868	1,051,861	330,329
Impact of non-cash working capital items	59,879	156,530	129,232	(135,710)	144,470	209,968
Funds flow from operations	187,030	733,442	370,974	223,158	1,196,331	540,297

## FIELD LEVEL CASH FLOW

\$, except as indicated	Three months ended May 31			Six months ended May 31		
	2009	2008	2007	2009	2008	2007
Oil and natural gas sales	690,939	1,253,689	957,150	1,303,678	2,204,126	1,685,082
Royalty expense	(89,876)	(163,621)	(122,772)	(174,219)	(287,463)	(216,141)
Net sales	601,063	1,090,068	834,378	1,129,459	1,916,663	1,468,941
Operating expenses (incl. Transportation)	204,089	166,019	195,154	416,998	301,147	430,056
Field level cash flow Per share - basic & diluted	396,974 0.03	924,049 0.06	639,224 0.05	712,461 0.05	1,615,516 0.11	1,038,885 0.07

## OPERATING NETBACKS

\$/BOE	Three months ended May 31			Six months ended May 31		
	2009	2008	2007	2009	2008	2007
Oil sales	58.61	107.82	63.85	49.48	96.91	62.12
Natural gas sales	31.57	65.81	56.60	38.37	59.25	54.85
Total sales	48.79	96.10	62.16	45.46	87.10	60.24
Royalty expense	(6.35)	(12.54)	(7.97)	(6.07)	(11.36)	(7.73)
Operating expenses (incl. transportation)	(14.41)	(12.73)	(12.67)	(14.54)	(11.90)	(15.37)
Netback	28.03	70.83	41.51	24.84	63.84	37.14

## PETROLEUM AND NATURAL GAS SALES

All of the Company's production is sold within Canada, and revenues are received in Canadian dollars. The commodities produced and sold are sensitive to both worldwide (crude oil) and North American (natural gas) price fluctuations and the Canada/U.S. exchange rate. An increase in the value of the Canadian dollar negatively impacts price realizations. There was a significant decrease in the value of the Canadian dollar versus the U.S. dollar in the second quarter of 2009 compared to the same period in 2008. The average Canada/U.S. exchange rate was \$1.21/\$1.00 in Q2 2009 compared to \$1.01 during Q2 2008.

Production sales of petroleum and natural gas in the second quarter of 2009 averaged 154 BOE/day, and realized an average gross price of \$48.79/BOE. This compares to 142 BOE/day in Q2 2008 with an average price of \$96.10/BOE, a decrease of 49% in the average price. The overall decrease in realized price/BOE can be primarily attributed to the significant decrease in the price/barrel (bbl) of worldwide crude oil prices during the second quarter of 2009 compared to the significant increase during 2008. This contributed to a 46% decrease in the realized price/bbl of oil compared to 2008. At the same time, the price/BOE of natural gas production decreased 52% from Q2 2008 levels. Oil revenues were helped by lower than normal declines in production volumes in 2009 of approximately 4%. Production volumes of natural gas increased by 41% in the second quarter of 2009 compared to Q2 2008 due to new production volumes from the Mikwan property in Alberta. The four new Mikwan wells contributed an average of 14 BOE/day.

### *Production History*

The following table summarizes the Company's production sales volumes for the three months and six months ended May 31, 2009, and 2008.

Volumes	Three months ended May 31						Six months ended May 31					
	2009		2008		2007		2009		2008		2007	
	Q2	/Day	Q2	/Day	Q2	/Day	Q2	/Day	Q2	/Day	Q2	/Day
Oil - Mstb & bbl/d	9,018	98	9,406	102	11,821	128	18,289	100	18,712	102	20,737	114
Gas - MMcf & Mcf/d	30,858	335	21,837	237	21,458	233	62,345	343	39,568	216	43,409	239
MBOE (6:1) & BOE/d	14,161	154	13,046	142	15,397	167	28,680	158	25,307	138	27,972	154

In February 2009, the Warwick 6-17-IV well (50% Working Interest - net 3 BOE/day) developed a production casing leak, and a bridge plug was set to shut off the flow of water into the reservoir. The well was shut-in. On June 1, using Weatherford Canada temperature log equipment, the location of the production casing leaks was found. A workover was designed to repair the leak. The Company's partner signed the Authority For Expenditure on July 6. It is anticipated that the workover will be completed by the end of July.

## Sales Summary

The following table details the oil and gas sales volumes and values for the three months and six months ended May 31, 2009 and 2008.

	Three months ended May 31			Six months ended May 31		
	2009	2008	2007	2009	2008	2007
Oil volumes - bbl	9,018	9,406	11,821	18,289	18,712	20,737
Oil price - \$/bbl	58.61	107.82	63.85	49.48	96.91	62.12
Gross oil sales (\$)	528,552	1,014,191	754,736	904,985	1,813,379	1,288,245
Natural gas volumes - Mcf	30,858	21,837	21,458	62,345	39,568	43,409
Natural gas price - \$/Mcf	5.26	10.97	9.43	6.39	9.88	9.14
Gross natural gas sales (\$)	162,387	239,498	202,414	398,693	390,747	396,837

bbl = one barrel of oil      cf = ft<sup>3</sup> of natural gas      M = one thousand

## ROYALTIES

Royalty burdens are predominantly freehold and overriding, along with some Crown royalties related specifically to the Mikwan Alberta production. For the second quarter of 2009, royalty rates remained relatively constant at approximately 13%, as tabled below.

Royalties	Three months ended May 31			Six months ended May 31		
	2009	2008	2007	2009	2008	2007
\$ - except as indicated						
Oil	64,538	134,389	98,296	112,835	239,907	168,177
Gas	25,338	29,232	24,476	61,384	47,556	47,964
Total Royalties	89,876	163,621	122,772	174,219	287,463	216,141
- \$/BOE	6.35	12.54	7.97	6.07	11.36	7.73
- rate %	13.01	13.05	12.83	13.36	13.04	12.83

## CASH COSTS

An increase in BOE production sales rates and reduced interest costs as a result of lower bank indebtedness and interest rates throughout the period, assisted to offset the cash costs (operating, general and administrative and interest) increase of 6% to \$30.42/BOE in Q2 2009 from \$28.63/BOE in Q2 2008.

	Three months ended May 31			Six months ended May 31		
	2009	2008	2007	2009	2008	2007
\$, except as indicated						
Operating, G&A, & Interest	430,778	373,467	476,119	848,367	751,110	954,716
- \$/BOE	30.42	28.63	30.92	29.58	29.68	34.13

## Operating Expenses

Operating expenses for the second quarter of 2009 increased to \$204,089 compared to \$166,019 for the same period in 2008, representing a 23% increase. The increase resulted primarily from the addition of accrued estimated costs related to the new wells at Mikwan and actual new costs for RamBP#4 and a reduction in Q2 2008 repairs and maintenance in the Dover East field. On a BOE basis, Q2 2009 operating costs were \$14.41/BOE compared to \$12.73/BOE in Q2 2008.

	Three months ended May 31			Six months ended May 31		
	2009	2008	2007	2009	2008	2007
\$, except as indicated						
Operating, excluding Transportation	181,472	141,649	168,462	370,968	254,303	382,224
Transportation	22,617	24,370	26,692	46,030	46,844	47,832
Operating Expenses	204,089	166,019	195,154	416,998	301,147	430,056
- \$/BOE	14.41	12.73	12.67	14.54	11.90	15.37

### *General & Administrative Expenses*

Net general and administrative expenses increased 33% to \$205,334 in the second quarter of 2009 from \$153,835 in Q2 2008. General and administrative costs were higher in Q2 2009 primarily due to labour and labour related costs. During the second quarter of 2009, the Company capitalized \$27,586 (2008 - \$24,922) of general and administration expenses related to geology and the development of oil and gas properties. General and administrative expenses are not expected to change in any material amount during the fiscal 2009 period.

General and Administrative	Three months ended May 31			Six months ended May 31		
	2009	2008	2007	2009	2008	2007
\$, except as indicated						
Gross	232,920	178,757	220,707	439,172	372,545	401,872
Capitalized amounts	(27,586)	(24,922)	(21,930)	(56,664)	(45,692)	(43,860)
Net	205,334	153,835	198,777	382,508	326,853	358,012
- \$/BOE	14.50	11.79	12.91	13.34	12.92	12.80

### *Interest Expenses*

Interest expenses decreased to \$21,355 during the second quarter of 2009 from \$53,613 in Q2 2008. The decrease is primarily due to reduced bank indebtedness and declining interest rates (see also Liquidity, page 8).

	Three months ended May 31			Six months ended May 31		
	2009	2008	2007	2009	2008	2007
\$, except as indicated						
Bank debt	21,355	53,118	81,419	48,681	122,038	165,024
Capital lease and other	0	494	769	180	1,072	1,624
Interest Expenses	21,355	53,613	82,188	48,861	123,110	166,648
- \$/BOE	1.51	4.11	5.34	1.70	4.86	5.96

## **NET EARNINGS**

The Company realized a profit of \$30,816 (\$0.00 per share) for the 3 months ended May 31, 2009 compared to a profit of \$549,103 (\$0.04 per share) for the same period in 2008. Oil and gas revenues less royalties decreased to \$601,063 in Q2 2009 versus \$1,090,068 in Q2 2008. The main contributing factor for the decreases can be attributed to significantly higher commodity prices for both oil and natural gas during the second quarter of 2008 as compared to the same period for 2009. This was partially offset by stable oil production volumes and increased gas production volumes.

	Three months ended May 31			Six months ended May 31		
	2009	2008	2007	2009	2008	2007
\$, except as indicated						
Net Earnings - Profit (Loss)	30,816	549,103	117,220	(20,317)	843,387	66,633
- per Share	0.00	0.04	0.01	(0.00)	0.06	0.00
Oil & Gas Revenue less Royalties	601,063	1,090,068	834,378	1,129,459	1,916,663	1,468,941

## OTHER ITEMS

### *Depletion, Amortization & Accretion Expenses*

The fair values of asset retirement obligations are recorded as liabilities on a discounted basis when they are incurred, which is typically when the related assets are acquired or installed. Amounts recorded for the related assets are increased by the amount of these obligations. Over time the liabilities will be accreted for the change in their present value and the initial capitalized costs will be depleted and amortized over the useful lives of the related assets. There are no asset retirement liabilities set up for those assets which have an indeterminate useful life.

Depletion, amortization and accretion decreased to \$157,656 in the second quarter of 2009 from \$185,694 in 2008. On a BOE basis, depletion, amortization and accretion decreased 22% from \$14.23 to \$11.13.

\$, except as indicated	Three months ended May 31			Six months ended May 31		
	2009	2008	2007	2009	2008	2007
Depletion and amortization	147,963	173,577	241,367	319,624	334,561	447,622
Accretion - ARO	9,693	12,117	14,982	19,386	24,234	29,964
Total	157,656	185,694	256,349	339,010	358,795	477,586
- \$/BOE	11.13	14.23	16.65	11.82	14.18	17.07

### *Asset retirement obligation (ARO)*

The undiscounted amount of expected cash flows required to settle the asset retirement obligations is estimated at \$1,544,668 (2008 - \$1,920,279). The liability for the expected cash flows, as reflected in the consolidated financial statements, has been discounted at 9% and includes a 1.0% inflation factor.

The schedule below is a continuity of the Company's liability for the period ended May 31, 2009.

	2009 (\$)
Asset retirement obligation, beginning of the period	427,843
Asset retirement costs incurred	(95,535)
Accretion expense	19,386
Asset retirement obligation, end of period	351,694

Costs attributable to these commitments and contingencies are expected to be incurred over an extended period of time and are to be funded mainly from the Company's cash provided by operating activities. Over the next 5 years, approximately 18% of the costs will be incurred and the remainder from 2014 to 2058. Although the ultimate impact of these matters on operations cannot be determined at this time, it could be material for any one quarter or year.

In respect of future abandonment commitments, the Company is required by statute to establish a bond with a Trustee relating to a Trust Agreement with the Ontario Ministry of Natural Resources as the beneficiary. As at May 31, 2009, the balance of this bond was \$70,000.

## INCOME TAXES

The Company uses the liability method to account for income taxes. Under this method, future tax assets and liabilities are determined based upon differences between the financial reporting and tax bases of assets and liabilities, and measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company has approximately \$7.6 million in tax pools together with approximately \$5.6 million in successor tax pools available to recognize against potential taxable income. The potential income tax benefits associated with unutilized tax pools have been recognized to the extent of reducing future tax liabilities and thus no tax provision has been made.

## CAPITAL EXPENDITURES

Net capital expenditures totalled \$157,947 in the second quarter of 2009 compared to \$149,432 in 2008. The capital expenditures for the three and six months ended May 31 2007, 2008, and 2009 are summarized below:

(\$000)	Three months ended May 31			Six months ended May 31		
	2009	2008	2007	2009	2008	2007
Canadian expenditures:						
Lease and land acquisitions	44	41	52	100	75	61
Geological & geophysical	20	19	9	104	37	39
Drilling, completion and workovers	58	9	49	63	11	78
Equipping and facilities	9	55	0	10	55	0
Capitalized administration and other	27	25	22	64	65	45
<b>Subtotal</b>	<b>158</b>	<b>149</b>	<b>132</b>	<b>341</b>	<b>243</b>	<b>223</b>
Asset retirement obligation adjustment	0	0	0	0	0	0
Disposition of oil and gas properties	0	0	0	0	0	0
<b>Net Canadian Expenditures</b>	<b>158</b>	<b>149</b>	<b>132</b>	<b>341</b>	<b>243</b>	<b>223</b>

The Company's capital expenditures were primarily related to the drilling, completion and tie-in costs of the Mikwan project in Alberta together with continued geological and geophysical assessments of the projects in S.W. Ontario.

## LIQUIDITY AND CAPITAL RESOURCES

The Company's working capital deficiency decreased to \$2,709,623 at May 31, 2009 from \$3,029,925 at May 31, 2008. This decrease is a result of utilizing cash flow from operations to retire a portion of the bank debt during the year. In the short term, the Company is able to meet its liabilities as they come due. Additional financing may be required to rectify the working capital deficiency.

On April 29, 2009 the Company established a revised credit facility in the amount of \$6,100,000. The credit facility provides Torque with a revolving demand loan bearing interest payable monthly at the bank's prime lending rate plus 1.50%. As at May 31, 2009, the bank's prime lending rate was 2.25%. The loan is collateralized by a General Assignment of Book Debts together with a fixed and floating \$20,000,000 debenture over all Torque's assets.

At May 31, 2009, \$2,438,496 of funds had been drawn against the credit facility of \$6,100,000, leaving an available credit of \$3,661,504.

The bank has not waived its right to demand repayment of the outstanding principal balance and consequently the entire balance has been shown as a current liability.

In the second quarter of 2009, the Company funded its capital expenditure program from cash flow from operations and is expected to be able to continue to do so in the next quarter and remainder of the financial year.

Capital expenditures for the remainder of this fiscal year will be funded from unencumbered cash flow and may use the available bank credit facility.

## COMMITMENTS AND CONTRACTUAL OBLIGATIONS

The Company is committed to leased office premises and office equipment with future lease payments, plus common area costs as follows:

Year	\$
(6 months) 2009	24,507
2010	49,089
2011	16,553
2012	5,707
2013	5,707

### Other Indemnifications

In the ordinary course of business, the Company and its subsidiaries enter into contracts which contain indemnification provisions, such as loan agreements, confidentiality agreements, purchase contracts, service agreements, licensing agreements, asset purchase and sale agreements, joint venture agreements, operating agreements, leasing agreements, land use agreements, and others. In such contracts, the Company may indemnify counterparties to the contracts if certain events occur. These indemnification provisions vary on an agreement by agreement basis. In some cases, there are no pre-determined amounts or limits included in the indemnification provisions and the occurrence of contingent events that will trigger payment under them is difficult to predict. Therefore, the maximum potential future amount that the Company could be required to pay cannot be estimated.

## OFF-BALANCE SHEET ARRANGEMENTS

The Company does not have and is not expected to have during its 2009 fiscal year any off-balance sheet arrangements.

## RELATED PARTY TRANSACTIONS

During the six months ended May 31, 2009, \$15,000 (2008 - \$15,000) was paid for office facilities and administrative services to a company (Ionic Management Corp.) related by virtue of a common director (Brian E. Bayley).

## BUSINESS RISKS

The Company's business is the acquisition, exploration, development and any other opportunities related to the operation and production of oil and natural gas properties. In addition, the Company is exposed to a number of risks. Please refer to page 8 of the annual MD&A under the heading Business Risks, as well as Note 11 of the Consolidated Financial Statements for the six month period ended May 31, 2009, for a complete assessment of such risks.

## CRITICAL ACCOUNTING ESTIMATES

### *Oil and Gas Properties*

The preparation of consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

The Company follows the full cost method of accounting for oil and gas operations whereby all costs of exploring for and developing oil and gas reserves are initially capitalized. Such costs include land acquisition costs, geological and geophysical expenses, carrying charges on non-producing properties, costs of drilling and overhead charges directly related to acquisition and exploration activities.

Costs capitalized, together with the costs of production equipment, are depleted and amortized on the unit-of-production method based on the estimated gross proved reserves as determined by independent petroleum engineers. Petroleum products and reserves are converted to a common unit of measure, using 6 Mcf of natural gas to 1 Bbl of oil.

Costs of acquiring and evaluating unproved properties are initially excluded from depletion calculations. These unevaluated properties are assessed periodically to ascertain whether impairment has occurred. When proved reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to costs subject to depletion calculations.

Proceeds from sale of petroleum and natural gas properties are applied against capitalized costs, with no gain or loss recognized, unless such a sale would alter the rate of depletion by more than 20%.

## **NEW ACCOUNTING STANDARDS**

The CICA has issued the following new Standards that will become effective for the Company:

- CICA Handbook Section 3064, Goodwill and Intangible Assets
- Adoption of International Financial Reporting Standards

In February 2008, the CICA issued new CICA 3064, Goodwill and Intangible Assets, replacing CICA 3062, Goodwill and Other Intangible Assets, and CICA 3450, Research and Development Costs. New Section 3064 addresses when an internally developed intangible asset meets the criteria for recognition as an asset. The CICA also issued amendments to Section 1000, Financial Statement Concepts, and Accounting Guideline AcG-11, Enterprises in the Development Stage. EIC-27, Revenues and Expenditures during the Pre-operating Period, will not apply to entities that have adopted section 3064. The objectives of the changes are to reinforce a principle-based approach to the recognition of costs as assets and to clarify the application of the concept of matching revenues and expenses in CICA 1000. Collectively, these changes bring Canadian practice closer to International Financial Reporting Standards (“IFRS”) and U.S. GAAP by eliminating the practice of recognizing as assets a variety of start-up, pre-production and similar costs that do not meet the definition and recognition criteria of an asset. Consequently, such costs will be expensed as incurred. The effective date of adopting this new standard for the Company is December 1, 2008. This standard will have no effect on the Company’s consolidated net income.

The CICA’s Accounting Standards Board has announced that Canadian publicly accountable enterprises will adopt IFRS as issued by the International Accounting Standards Board effective January 1, 2011 and therefore will commence in the first quarter of the Company’s 2012 fiscal year with comparative figures. The Company will be developing a plan for the implementation of IFRS and will assess the impact of the differences in accounting standards on the Company’s consolidated financial statements. It is not practically possible at this time to quantify the impact of these differences at this time. The Company expects to make changes to processes and systems before the 2011 fiscal year in time to enable the Company to record transactions under IFRS for comparative purposes in the 2012 financial year reporting.

## **CONTROLS AND PROCEDURES**

During the six months ended May 31, 2009, there were no changes to internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company’s internal controls over financial reporting.

## SUMMARY OF SECURITIES AT THE END OF THE PERIOD

### Authorized

Unlimited common voting shares without par value  
100,000,000 Class 'A' preference shares, par value \$10  
100,000,000 Class 'B' preference shares, par value \$50

### Issued and outstanding

	2009	
	Shares	Amount
Common shares outstanding	13,837,698	\$ 12,143,910

### Stock Options:

As at May 31, 2009, options to purchase 1,180,000 shares have been issued. All options are fully vested and exercisable at a weighted average price of \$0.10 per share. There have been no options granted in the six months ended May 31, 2009.

### Basic and Diluted Share Amounts

	2009
Weighted average number of shares outstanding	13,837,698
Shares issuable pursuant to stock options	151,294
<b>Weighted average number of diluted shares outstanding</b>	<b>13,988,992</b>

## OUTLOOK

The Company continues to evaluate existing properties for production and asset value optimization.

As a result of an on-going review of its assets, the Company has initiated an assessment of some of its properties with the objective of determining their viability to function as commercial gas storage reservoirs. One of the outcomes of this review is that the Company has acquired 400 acres of petroleum and natural gas and storage rights at 100% working interest adjacent to one of its current producing properties. It is currently reprocessing and interpreting up to five lines of seismic and plans on shooting an additional three lines to assist in delineating a larger reef structure.

In February 2009, the Warwick 6-17-IV well (50% Working Interest - net 3 BOE/day) developed a production casing leak and a bridge plug was set to shut off the flow of water into the reservoir. The well was shut-in. On June 1, using Weatherford Canada temperature log equipment, the location of the production casing leak was found. A workover was designed to repair the leak. The Company's partner signed the Authority For Expenditure on July 6. It is anticipated that the workover will be completed by the end of July.

At Ram #91 and Reefex #1 (both 100% working interest) the Company is continuing to perform economic and pressure evaluations of the two shut-in gas wells with results expected by the fall.

The Company has acquired 3,002 acres of petroleum and natural gas rights at 100% working interest in the Dunwich-Southwold prospect area. This prospect and an additional seven prospects also located in southwestern Ontario were originally identified using high resolution magnetics. The Company has completed the SGH (soil gas hydrocarbon) sampling survey and is currently integrating these results into the geological/geophysical models to form a geological assessment report on each of these prospects. The Company is in discussions with two potential partners who may want to participate in the continuing development of these prospects.